

# **ANNUAL FINANCIAL REPORT OF CALIFORNIA K-12 SCHOOLS**

**Report to the Superintendent of Public Instruction**

*For the Period of July 1, 2005, through June 30, 2006*



**JOHN CHIANG**  
California State Controller

October 2007



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California State Controller

October 29, 2007

The Honorable Jack O'Connell  
State Superintendent of Public Instruction  
California Department of Education  
P.O. Box 944272  
Sacramento, CA 94244-2720

Dear Mr. Superintendent:

I am pleased to announce the completion of the *Annual Financial Report of California K-12 Schools* for 2006. The report summarizes the financial and program compliance status of the state's school districts, county offices of education, and charter schools for fiscal year (FY) 2005-06, unless otherwise specified. This was the first year the State Controller's Office collected charter school data. As a result, historical data is not available for comparison.

The financial health of most of California's 976 school districts and 58 county offices of education improved during FY 2005-06. As a whole, California's local educational agencies received more money than they spent, an improvement over last fiscal year. The number of districts and county offices of education filing negative or qualified interim certifications decreased. Approximately 260, or 25.15%, of the school districts and county offices of education incurred deficit spending.

State and federal compliance findings noted in the independent auditors' reports of school districts and county offices of education decreased from the prior year. Auditors reported 1,008 compliance findings in FY 2005-06, a 9.5% decrease from the 1,114 reported in FY 2004-05. Moreover, 32.6% of the compliance findings were related to deficiencies in average daily attendance (ADA) accounting, which is the primary basis for the allocation of state funding. The independent audit reports also noted that 76 of the 882 school districts (8.6%) participating in the Class-Size Reduction Program failed to fully comply with program reporting requirements, a decrease of 20.8% over the prior year. The auditors also reported 119 findings pertaining to the instructional materials fund.

The Honorable Jack O'Connell  
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I hope the report will be useful to you and the Legislature in planning California's future education needs. Please direct any comments regarding the content of the report to Michael Carter, Chief Operating Officer, at (916) 445-3028.

Sincerely,

*Original signed by*

JOHN CHIANG  
California State Controller

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# Executive Summary

The State Controller has broad authority to oversee state and federal funding of California's public schools from kindergarten through the 12th grade (K-12). The State Controller's goal is to promote greater fiscal accountability by local education agencies (school districts, county offices of education, and charter schools) and to function as the independent protector of taxpayer dollars.

This oversight responsibility includes reviewing annual local education agencies' audit reports, maintaining a database with financial and statistical data on local education agencies' audit reports, reviewing and certifying the audit reports submitted by independent auditors, tracking financially troubled school districts identified by the interim reporting process, developing and submitting the content of the *Standards and Procedures for Audits of California K-12 Local Educational Agencies* to the Education Audit Appeals Panel, and conducting financial and program audits at various local education agencies.

Most of the information used to prepare this report is compiled from annual audit reports prepared for individual local education agencies by independent certified public accountants for fiscal year 2005-06. This is the first year charter school data has been compiled and included in the report. Additional data was taken from interim financial report certifications submitted by school districts during fiscal year 2006-07. Information related to the emergency loan apportionments was obtained from various sources, including the California Department of Education.

This year's report contains the following key findings.

- California's local educational agencies, as a whole, received more money than they spent, an improvement over last fiscal year.
- Two school districts and 16 charter schools had deficient fund balances.
- The number of districts engaged in multi-year deficit spending decreased. Approximately 260, or 25.15%, of the 1,034 districts and county offices of education incurred deficit spending. Although some school districts may legitimately need to engage in multi-year deficit spending (such as for building projects), this practice is often an indication that a district is facing financial difficulties.
- Long-term borrowing decreased by \$253 million to a total of \$8.267 billion, a 2.97% decrease from the \$8.52 billion reported in the prior year. Generally, school districts issue long-term debt to fund capital improvements, refinance existing debt, or buy land for future use.

- The number of districts and county offices of education filing negative or qualified certifications during at least one of the two periods decreased, from 46 in fiscal year 2005-06 to 26 in fiscal year 2006-07. In the second reporting period of fiscal year 2006-07, 19 school districts and one county office of education filed qualified interim financial reports and four school districts filed negative interim financial reports. Two districts were able to take corrective action in the second reporting period. Continuing financial difficulties may have a negative impact on these districts' educational programs.
- The number of state and federal compliance findings contained in the audit reports of school district and county offices of education decreased over the prior year. Approximately 32.6% of the compliance findings for fiscal year 2005-06 are related to deficiencies in average daily attendance (ADA) accounting, which is the primary factor in determining the amount of funding a school district receives from the State.
- The number of rejected reports increased by 188 over the prior year, from 170 to 358. Approximately 236, or 66%, of the 358 reports rejected were charter school reports. The primary reason for rejection was that reports did not include the required report components.
- The school districts' annual audit reports disclosed that 76 of the 882 elementary school districts participating in the Class-Size Reduction Program failed to fully comply with the program requirements. The reports also disclosed 119 audit findings pertaining to the state instructional materials fund.

Overall, the financial health of most of California's 976 school districts and 58 county offices of education improved during FY 2005-06. We cannot comment on the overall financial health of charter schools because FY 2005-06 is the first year for which we have collected charter school data.

Although the California public school system includes 573 charter schools, the SCO could not determine the exact number of charter school reports that should have been submitted for fiscal year 2005-06 for the following reasons:

- Charter school petitions may have been approved by the State but the charter schools are not in business.
- Charter school names identified in the reports are not the same as the names that appear in the charter petitions approved by the State.
- Charter school audits are included in the sponsoring district's annual audit.

The SCO anticipates that continued monitoring of charter school reports will allow for a more accurate breakdown of the number of reports required within a given fiscal year.

# Introduction

The State Controller's Office's (SCO) oversight role in the K-12 fiscal process is administered by its Division of Audits. Oversight activities focus primarily on three areas: financial indicators, program compliance, and quality control.

The SCO is also responsible for financial oversight of local education agencies (school districts, charter schools, joint power entities, and county superintendents of schools). Beginning with fiscal year 2005-06, Education Code section 47634.2(d) rendered charter schools subject to audits pursuant to Education Code section 41020. That Education Code section requires that audits be conducted in accordance with California Code of Regulations, Title 5, Education, Section 19810, et seq. (the audit guide is also known as the *Standards and Procedures for Audits of California K-12 Local Educational Agencies 2005-06*.)

Each section of the report specifies the type of local education agency being reported on and the fiscal year for which the data was obtained.

In accordance with Education Code section 14500, SCO's responsibilities include:

- Developing, in consultation with the Department of Finance, the State Department of Education, and other school representatives, an annual audit guide<sup>1</sup> that prescribes financial statements and other information that should be included in each local education agency's audit report and that provides guidance to independent auditors conducting school district audits;
- Reviewing each local education agency's audit report submitted to the State and performing the associated follow-up actions, including compliance audits<sup>2</sup>;
- Tracking notifications from the school districts that identify substantial fiscal problems at interim reporting periods;

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<sup>1</sup> *Standards and Procedures for Audits of California K-12 Local Educational Agencies* (K-12 Audit Guide). The *Education Code* states that the Controller, in consultation with the California Department of Education, the California Department of Finance, representatives of the California School Boards Association, the California Association of School Business Officials, the California County Superintendents Educational Service Association, the California Teachers Association, and the California Society of Certified Public Accountants, shall recommend the statements and other information to be included in the audit reports filed with the State and shall propose an audit guide to carry out the purposes of this chapter. A supplement to the audit guide may be suggested during the audit year, to address issues resulting from new legislation in that year that changes the conditions of apportionment. The proposed content of the audit guide and any supplement to the audit guide shall be submitted by the Controller to the Education Audit Appeals Panel for review and possible amendment.

<sup>2</sup> Compliance audits are conducted to determine whether categorical state and federal program funds are expended in accordance with the applicable program laws and regulations.

- Conducting selected school districts' annual financial and compliance audits as a condition of the districts receiving emergency State apportionment loans;
- Ensuring that satisfactory arrangements for an annual audit have been made for each local education agency;
- Performing quality control reviews of independent auditors; and
- Compiling pertinent data and reporting annually to the California State Legislature and the California Department of Education.



# Financial Indicators

## Overview

The Education Code places school district finances under the control of county offices of education and the California Department of Education. The law protects the public's interest in education by giving county offices of education specific responsibility for fiscal oversight of districts within their jurisdictions.

Key financial indicators representing the financial health of local education agencies are presented in this section of the report. Most of the indicators are based on data from annual audit reports prepared by independent certified public accountants (CPAs) for fiscal year 2005-06. State law requires local education agencies to submit, approximately six months after the end of a fiscal year, an independent audit report to the State Controller's Office and the California Department of Education. Additional data comes from interim financial report certifications submitted by school districts during fiscal year 2006-07 and from audits conducted by the State Controller's Office.

## Interim Reporting

School districts in California are required to file interim reports certifying their financial health to the governing board of the district and to the county office of education. These interim reports must be completed twice a year by every school district (to cover the periods of July 1 through October 31, and November 1 through January 31) and must be reviewed by the appropriate county superintendent of schools. The interim reports must be in a format or on forms prescribed by the State Superintendent of Public Instruction and shall be based on Standards and Criteria for Fiscal Stability adopted by the State Board of Education pursuant to Education Code section 33127.

One of the following three certifications must be designated by the school district or county office of education when certifying the district's fiscal stability on the interim report.

**Positive:** A school district or county office of education that **will** meet its financial obligations for the **current fiscal year and subsequent two fiscal years**.

**Qualified:** A school district or county office of education that **may not** meet its financial obligations for the **current fiscal year or subsequent two fiscal years**.

**Negative:** A school district or county office of education that **will not be able to** meet its financial obligations for the **current fiscal year or subsequent fiscal year**.

School districts that file qualified or negative interim reports work with their county school superintendent to implement corrective action. Copies of the qualified or negative certifications are forwarded to the State Controller's Office and the Superintendent of Public Instruction.

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***Decrease in the  
number of districts  
that filed qualified or  
negative certifications***

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During fiscal year 2006-07, 19 of the 976 school districts and 58 county offices of education in the state filed a qualified certification, and 3 districts filed a negative certification for the first period interim report. Of the 22 local education agencies, 16 filed a second-period qualified interim report, 4 filed a second-period negative report, and 2 districts were able to take corrective action. However, an additional 4 districts filed qualified or negative second-period interim reports, for a total of 24 local education agencies filing qualified or negative certifications for the second-period interim report (Table 1). Thus, 25 districts and 1 county office of education reported qualified or negative certifications for at least one of the two periods (Appendix A), and 10 school districts and one county office of education remained on the list from the prior year. Local education agencies filing qualified or negative interim reports for two or more years are monitored closely by the SCO through continuous contact with the California Department of Education.

The most common causes of fiscal problems cited in qualified or negative certifications were (Appendix B):

- Deficit spending
- Salary and benefit issues
- Declining enrollment
- Loss of forest reserve funds
- Inadequate reserves

**Table 1**

<b>SECOND-PERIOD INTERIM REPORTING HISTORY</b>					
	<u><b>2002-03</b></u>	<u><b>2003-04</b></u>	<u><b>2004-05</b></u>	<u><b>2005-06</b></u>	<u><b>2006-07*</b></u>
Positive	978	996	979	1,003	1,010
Qualified	55	35	47	29	19
Negative	<u>8</u>	<u>9</u>	<u>14</u>	<u>4</u>	<u>5</u>
Totals	<u><b>1,041</b></u>	<u><b>1,040</b></u>	<u><b>1,040</b></u>	<u><b>1,036</b></u>	<u><b>1,034</b></u>
* Additional information regarding local education agencies that filed qualified or negative interim reports during fiscal year 2006-07 is provided in Appendices A and B.					

## **Deficit Spending**

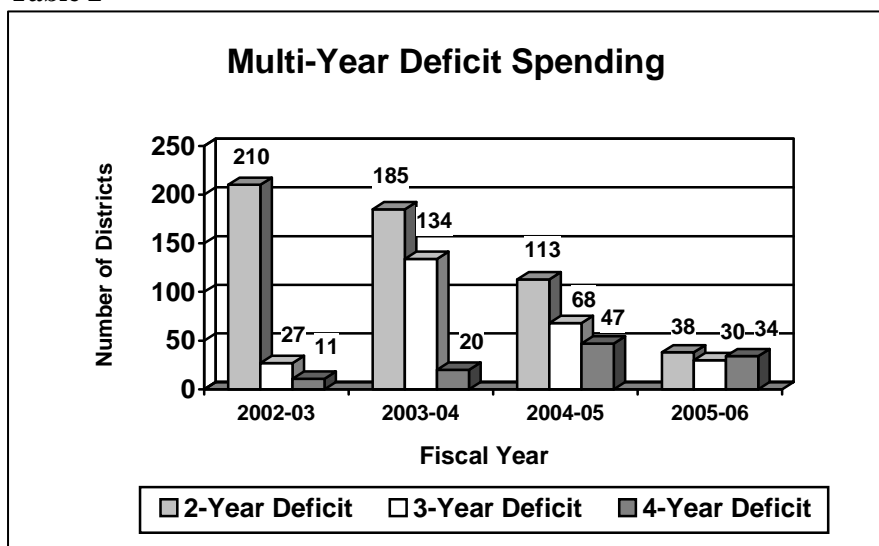
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***School district  
multi-year deficit  
spending decreases***

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During fiscal year 2005-06, single-year deficit spending increased to 158 districts from 122 districts in the prior fiscal year. The data collected also revealed that approximately 30 charter schools had deficit spending.

The overall number of districts relying on multi-year deficit spending decreased (Table 2). Approximately 260, or 25.15%, of the 1,034 school districts incurred deficit spending. Deficit spending patterns are closely monitored by the county offices of education and the California Department of Education to determine whether the districts are facing serious financial problems.

**Table 2**

## Emergency Apportionments

When the governing board of a school district determines that the district's revenues are not sufficient to meet its current-year obligations, it may request, through legislation, an emergency apportionment loan. As a condition of acceptance of the loan, the superintendent appoints an administrator or trustee to control, monitor, and review the operation of the district. The administrator or trustee helps the district develop a five-year recovery plan.

### *School districts making timely payments*

During the past 25 years, the State has granted more than \$224 million in emergency loans to school districts from the general fund. The emergency loans are designed to provide an advance of apportionments owed to the districts from the State School Fund.

**Table 3**

DISTRICTS WITH OUTSTANDING LOANS (in millions)							
Fiscal Year	School District	Initial Loan			Lease Revenue Bonds*		
		Amount of Loan	Out-standing Balance	Final Repay-ment Date	Amount Issued	Out-standing Balance	Final Repay-ment Date
1990-91	West Contra Costa Unified	\$28.5	—	12/08/2005	\$15.7	\$14.3	08/15/2018
2001-02	Emery Unified	\$2.3	\$1.07	09/30/2021	—	—	—
2002-03	West Fresno Elementary	\$2.0	\$0.94	12/30/2013	—	—	—
2002-03	Oakland Unified	\$100.0	\$35	06/05/2026	\$59.8	\$52.3	08/15/2023
2003-04	Vallejo City Unified	\$60.0	\$18.4	06/24/2024	\$21.2	\$18.4	08/15/2024

\* The lease revenue bond information was obtained from the California Infrastructure and Economic Development Bank.

During fiscal year 2005-06, five districts had general fund loan balances in amounts ranging from \$0.94 million to \$35 million. Assembly Bill (AB) 1554 was enacted during fiscal year 2003-04 to authorize West Contra Costa Unified School District and Oakland Unified School District to use lease financing to repay the emergency apportionments made from the State's general fund. AB 1554 also specifies that the emergency loan made to the Vallejo City Unified School District should be considered an interim loan and requires that the interim loan be repaid with the proceeds of a lease financing.

The lease financing specified in AB 1554 is made available by the California Infrastructure and Economic Development Bank (I-Bank) and shall not exceed 20 years. I-Bank issues the bonds to finance the emergency apportionments and related costs. In December 2005, I-Bank issued bonds to reduce or eliminate the initial loans, as identified in Table 3.

The lease financing payments for Vallejo Unified School District, West Contra Costa Unified School District, and Oakland Unified School District are due monthly over a seven-month period, from July through January of each fiscal year.

Annual payments on the initial emergency loans for the Oakland Unified School District, Emery Unified School District, and West Fresno Elementary School District are due in June, September, and December, respectively. Vallejo City Unified School District annual payments are due in June.

## General Fund Revenues and Expenditures

For fiscal year 2005-06, general fund revenues exceeded expenditures by \$1.24 billion (Table 4).

**Table 4**

<b>SCHOOL DISTRICT GENERAL FUND REVENUES AND EXPENDITURES (in billions)</b>									
	<b>Fiscal Years</b>								
	<b>1997-98</b>	<b>1998-99</b>	<b>1999-2000</b>	<b>2000-01</b>	<b>2001-02</b>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>	<b>2005-06</b>
Revenues	\$32.893	\$35.715	\$38.793	\$44.262	\$45.323	\$44.939	\$46.159	\$49.643	\$51.964
Expenditures	<u>(32.017)</u>	<u>(34.675)</u>	<u>(37.690)</u>	<u>(42.804)</u>	<u>(44.342)</u>	<u>(44.774)</u>	<u>(46.372)</u>	<u>(48.702)</u>	<u>(50.724)</u>
Surplus/(Deficit)	\$ .876	\$ 1.040	\$ 1.103	\$ 1.458	\$ .981	\$ .165	\$ (.213)	\$ .941	\$ 1.240

The cumulative fund balance or surplus for California local education agencies totaled \$5.939 billion at the end of fiscal year 2005-06, an increase of \$847 million from the prior year's total of \$5.092 billion. Approximately \$84 million of the \$847 million increase pertains to charter schools. As part of the total fund balance, the districts are to maintain reserves as a defense against economic uncertainties. The California Department of Education issues guidelines regarding the amount of reserve each district should maintain, based on its total average daily attendance.

## General Fund Balances

In their interim reports, school districts report to county offices of education on projected general fund balances and reserve levels for the current period and two subsequent years. The primary purpose of this reporting is to identify potential deficit spending early in the process, so that the trend can be reversed.

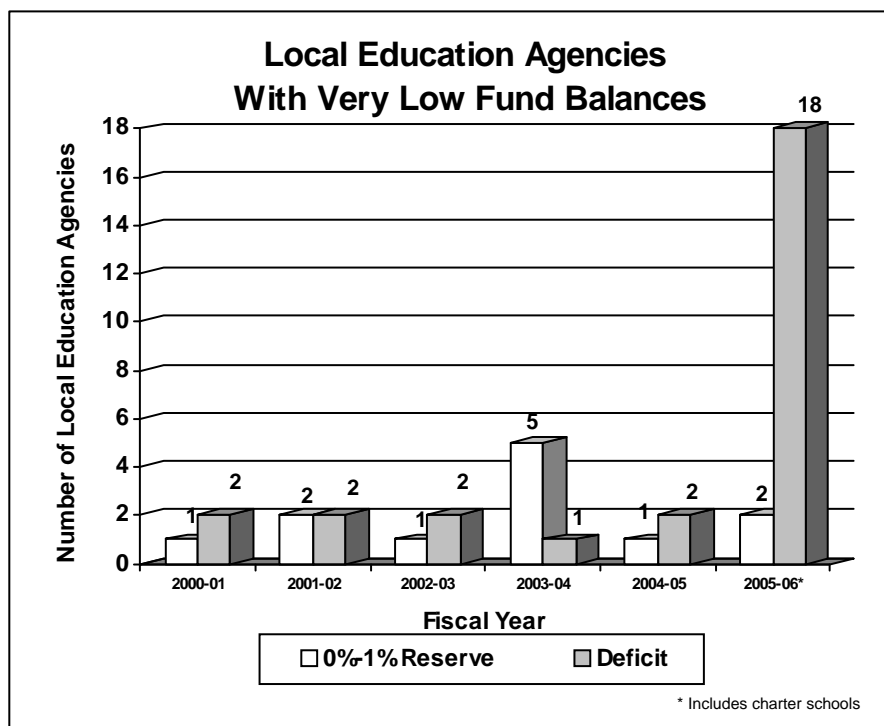
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***Number of school districts with deficient fund balances remains unchanged***

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Consistent with last year, two school districts had deficit fund balances. The data also revealed that 16 charter schools had deficit fund balances at the end of fiscal year 2005-06 (see Table 5).

**Table 5**



**Long-Term  
Borrowing**

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***School districts' issuance of long-term financing decreased***

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Generally, long-term debt is issued by districts to: fund the purchase, construction, or lease of buildings and equipment; refinance existing debt; or buy land for future use. In the past, it was not uncommon for financially troubled districts to issue long-term debt in order to finance current operations.

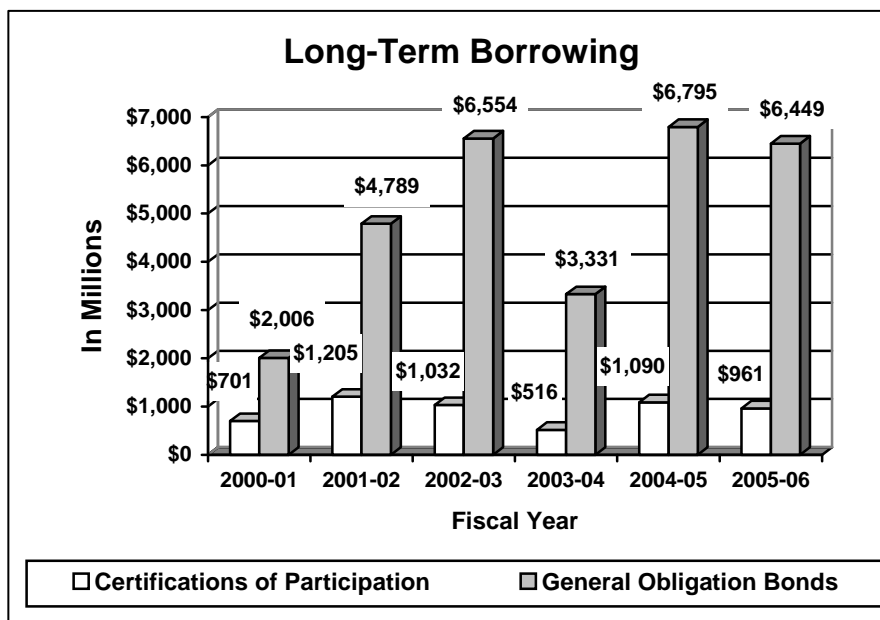
During fiscal year 2005-06, school districts issued \$8.267 billion in long-term debt, a decrease of \$253 million over the prior year (2.97%). Based on the information available, this decrease was due to districts issuing long-term debt in smaller amounts than in the prior year. Long-term debt financing included:

- **Certificates of Participation (\$961 million, or 11.63%)**—A financing technique that provides long-term financing through leasing of school facilities, such as buildings, with either an option to purchase or a conditional sales agreement.
- **General Obligation Bonds (\$6.449 billion, or 78.01%)**—Bonds secured by the full faith and credit of the district. These long-term obligations are generally issued at more favorable rates than are other types of debt because of their preferred status; that is, they are secured by the taxing authority of the district.

- **Limited Tax Obligation Bond Instruments and Other Debt (\$857 million, or 10.36%)**—A financing technique that provides long-term financing of capital projects. The bonds are repaid from incremental taxes on property in a redevelopment area.

School districts issued \$7.410 billion in certificates of participation and general obligation bonds during fiscal year 2005-06, a decrease of \$475 million (6.02%) from the \$7.885 billion in the prior year (Table 6).

**Table 6**



Financing through certificates of participation decreased by \$129 million and financing through general obligation bonds decreased by \$346 million over the prior year. The certificates of participation were issued by 67 school districts during fiscal year 2005-06.

Certificates of participation accounted for 11.63% of long-term borrowing in fiscal year 2005-06, a 1.37% decrease from the previous year. In comparison, general obligation bonds accounted for 78.01% of long-term borrowing in fiscal year 2005-06, a decrease of 1.99% from the previous year.

## Lottery Revenues

The allocation of lottery revenues to K-12 school districts is based on a percentage of total lottery sales for the year. Under state law, a minimum of 34% of lottery sales must be distributed to school districts, community colleges, and other educational agencies. The division of this 34% between K-12 school districts and junior colleges fluctuates annually.

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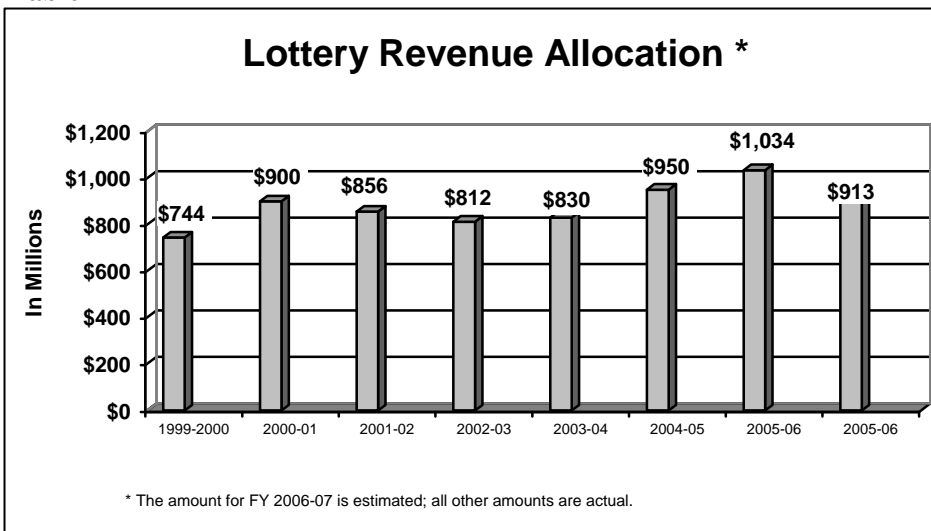
### *Lottery revenues projected to decrease*

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The amount is distributed to each district based on its K-12 average daily attendance. The data regarding sales and allocations are maintained by the State Controller's Office and the California State Lottery.

During fiscal year 2005-06, lottery revenue allocated to school districts increased, due to higher sales. Revenue for fiscal year 2006-07 is projected to decrease by 11.73% as compared to fiscal year 2005-06, down to \$912.7 million<sup>3</sup>—approximately \$137 per K-12 average daily attendance (Table 7).

**Table 7**



<sup>3</sup> The lottery revenue information is obtained from the California Department of Education, based on State Lottery projections.

# Program Compliance

## Overview

The State Controller's Office reports on program compliance issues as part of its review of annual audit reports, the overall certification process, and associated follow-up actions. In addition, the State Controller's Office conducts compliance audits.

## Compliance Findings

Independent auditors determine whether the local education agencies, including joint powers entities, have complied with state and federal laws and regulations that may have a material effect on the financial position and operations of the organization or program(s) under audit. The joint powers entities are formed to provide a joint service to a group of districts; the entities are governed by a board consisting of a representative from each member district. When a local education agency is not in compliance with applicable laws and regulations, the findings are communicated by the independent auditors in the audit report.

The number of compliance findings contained in the fiscal year 2005-06 school district and county office of education financial reports submitted by Certified Public Accountants (CPAs) decreased over the prior year. There were 1,008 compliance findings in fiscal year 2005-06, a 9.5% decrease over the 1,114 reported in fiscal year 2004-05 (see Appendix C). The number of attendance accounting findings decreased by 22 (from 336 to 314, or 6.5%) from the prior year. The compliance findings noted in the charter school reports reviewed by SCO totaled 24. As noted in the deficiencies section of the report, the majority of the charter school reports have been rejected; the corresponding revisions have not been received by the SCO.

Some of the problems identified in the compliance findings may have a fiscal impact on district operations, as they may result in a loss of state and federal funding. Of the 1,008 audit findings, 838 (83.1%) pertained to state programs and requirements and 170 (16.9%) pertained to federal programs and requirements (see Table 8). Attendance-related findings accounted for 32.6% of compliance findings. The majority of the attendance findings, accounting for approximately 76.8% of all attendance findings, were related to:

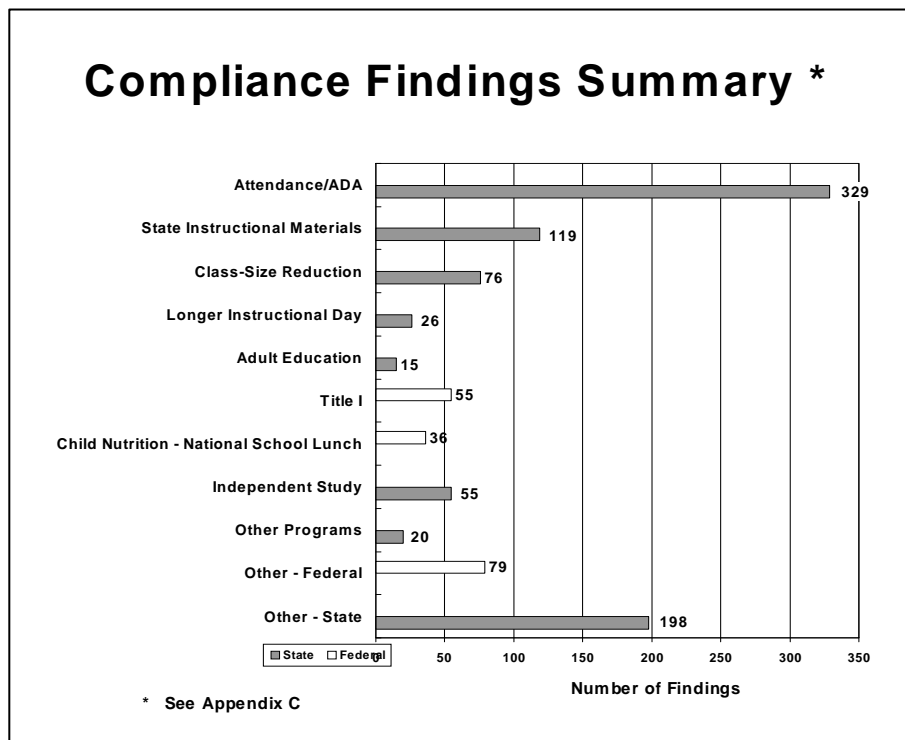
- Overstatement of ADA;
- Kindergarten continuation forms not being maintained and/or not in compliance with state requirements;
- Attendance reports being inaccurate or incomplete;
- Understatement of ADA;
- Absences claimed for apportionment; and
- Teachers not possessing a valid certification document.



The fiscal year 2005-06 school district audit reports also found that 8.6% of the 882 elementary school districts participating in the Class-Size Reduction Program did not fully comply with program reporting requirements. The audits identified 76 findings relating to the class-size reduction program.

The audits also disclosed 119 findings pertaining to the State Instructional Materials Fund. The types of findings ranged from districts not holding public hearings to board resolution deficiencies.

**Table 8**



## Reporting of Findings

Annual audit reports by CPAs are the primary source of information regarding a local education agency's financial stability and its compliance with state and federal program requirements. Local education agencies' noncompliance with program laws and regulations were not always included in the audit reports. Some compliance problems were either reported to the local education agency in the independent auditor's management letter or went undetected by the independent auditor.

## Audit Resolution Process

Education Code section 41020(n) requires the State Controller to annually select a sample of county offices of education on which to perform a follow-up review of the audit resolution process. The scope of the reviews was limited to determining whether each county office of education followed its audit resolution process, resolved all of the audit findings, followed up on the district's corrective action plans, and notified the Superintendent of Public Instruction and SCO of its results.

In fiscal year 2006-07, the SCO performed reviews of the audit resolution processes of four county offices of education.

Our reviews disclosed that one county office of education did not have a documented audit resolution process for fiscal year 2002-03. In addition, the certification of corrective action was submitted late to the State. However, we did find that the county office of education implemented and followed its audit resolution process in the subsequent fiscal year. The remaining three county offices of education complied with the applicable audit resolution process requirements specified in the Education Code.

# Quality Control

## Overview

The State Controller, under Education Code section 14504, reviews and certifies the annual independent audit reports submitted by each local education agency (school district, county office of education, charter school and joint powers entity) for compliance with audit guidelines set out in the *Standards and Procedures for Audits of California K-12 Local Educational Agencies* (K-12 Audit Guide).

## Audit Report Certifications

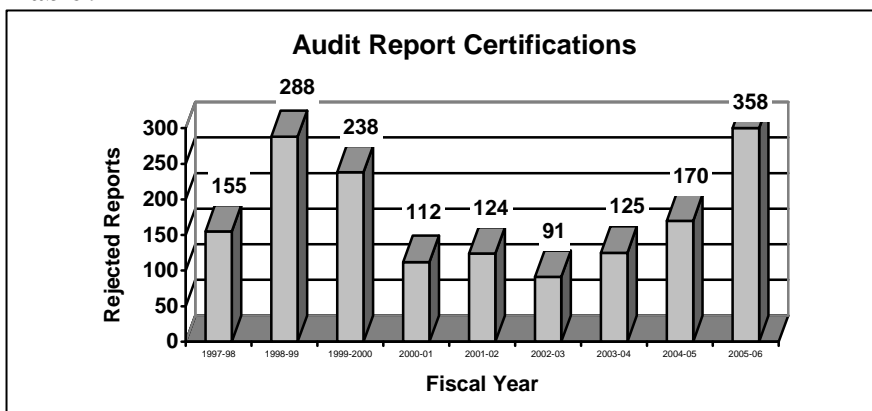
The SCO determines whether audit reports conform to reporting provisions of the K-12 Audit Guide and notifies each local education agency, independent auditor, and the State Superintendent of Public Instruction as to whether its report has been accepted or rejected, based on its conformity with those provisions.

For fiscal year 2005-06, the SCO accepted 72% of the audit reports; the remaining 28% were rejected upon initial review. The SCO subsequently accepted the rejected audit reports after the independent auditors made the requested corrections. Rejection of an auditor's report is accompanied by a penalty whereby the independent auditor does not receive its 10% service fee; this fee is retained by the local education agency until the audit report has been corrected and certified by the SCO. In addition, if an independent auditor has had a report rejected (and has not subsequently corrected it) for the same local education agency for two consecutive years, the auditor may be referred to the State Board of Accountancy for professional review.

### *Increase in rejected audit reports*

The number of rejected reports increased by 188 over the prior year, from 170 to 358, a 111% increase (Table 9). The number of rejections increased because it was the first year in which charter schools were required to submit reports to the SCO for review. Of the 358 reports rejected, 236 were charter school reports. The primary reasons for rejecting charter school reports include omission of required report components, deficiencies in supplemental information, and deficiencies in the findings and recommendations. Overall, the LEA rejections were a result of missing report components, errors in reporting state compliance requirements, and not quantifying the fiscal impact of state compliance findings.

**Table 9**

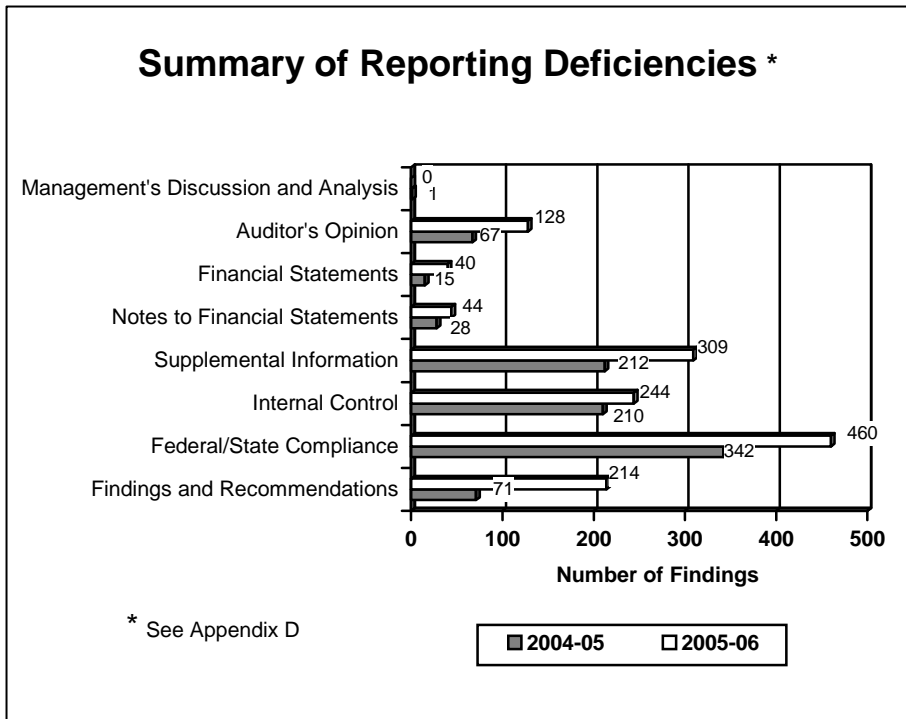


## Reporting Deficiencies

*Reporting deficiencies increased*

Upon initial review, the SCO certified 905 (72%) of the 1,265 audit reports submitted by independent CPAs for fiscal year 2005-06.

**Table 10**



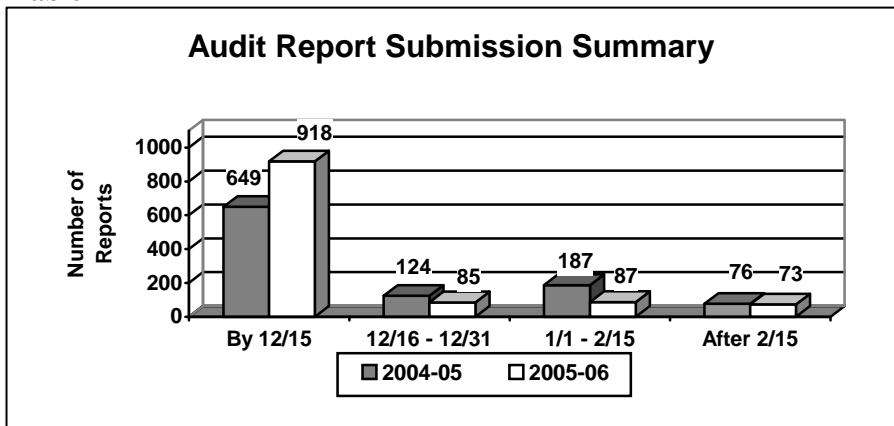
For fiscal year 2005-06, there were 1,439 reporting deficiencies, an increase of 493 from 946 in the prior year (Table 10). The reason for the increase is that this year's statistics include charter school reports. Of the 1,439 deficiencies noted, 569 related to charter school reports. School district and county office of education report deficiencies totaled 870, a decrease of 76 from the prior year.

## Timely Submissions

*Annual reports not submitted on time*

Audit reports for the preceding fiscal year must be filed with the SCO, the California Department of Education, and the county superintendent of schools by December 15. Filing deadline extensions may be granted, but only under extraordinary circumstances.

**Table 11**



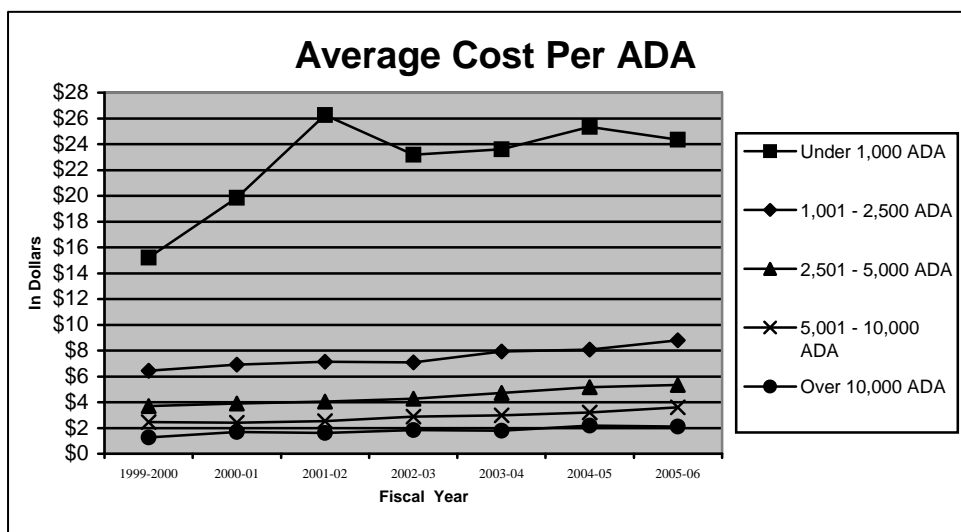
The number of annual school district and county office of education audit reports submitted by the deadline increased from the previous year (Table 11). Approximately 918, or 72.2%, of the 1,272 school district, county office of education, and charter school reports were received by the December 15 deadline. Seven reports are still outstanding.

## Average Audit Cost per ADA

*Average audit costs  
increased slightly*

The SCO maintains a database of information pertaining to audit contracts between local school districts and independent auditors. From that database, the SCO determined the total audit costs and cost per unit of ADA for school districts' annual audits. Audit costs for the fiscal year 2005-06 audits totaled \$21.1 million, an increase of \$1.61 million, or 8.3%, over total audit costs of \$19.48 million for fiscal year 2004-05. The largest increase of 12.5% (\$0.4), was for districts with 5,001–10,000 ADA (Table 12).

**Table 12**



## Quality Control Reviews

Under Chapter 1128, Statutes of 2002, the State Controller's effort in performing quality control reviews was expanded to include local education agencies that have received a negative budget/interim report certification and school districts that have a going concern issue, as determined by the county superintendent. Chapter 1128 also requires the SCO to publish a directory of CPAs whom it deems qualified to conduct audits of local education agencies. This directory is published by December 31 of each year.

Quality control reviews are necessary to ensure that the CPAs are adequately reviewing the local education agencies, are following generally accepted audit standards and government audit standards, and are including findings regarding financial stability and compliance with state and federal laws in their annual independent auditor's reports.

The general objective of the quality control reviews is to determine whether the independent auditors are conducting the annual financial audits of local education agencies in accordance with:

- Generally Accepted Government Auditing Standards (GAGAS);
- Generally Accepted Auditing Standards (GAAS);
- *Standards and Procedures for Audits of California Local Educational Agencies* (K-12 Audit Guide); and
- Office of Management and Budget (OMB) Circular A-133.

The SCO's opinion regarding the quality of the audits is classified in one of the following categories, based on whether the independent auditor performed the audit in accordance with auditing standards and state and federal requirements.

- If the audit was performed in accordance with the standards and requirements, the SCO's opinion would be that the independent auditor fully complied with auditing standards and state and federal requirements.
- If the audit was performed in accordance with the majority of the standards and requirements, the SCO's opinion would be that the independent auditor complied with the majority of auditing standards and state and federal requirements.
- If the audit was performed in accordance with some elements of the standards and requirements, but the majority of standards and requirements were not met, the SCO's opinion would be that the independent auditor complied with some elements of the standards and requirements, but that the majority of auditing standards and federal and state requirements were not met.
- If the audit was not performed in accordance with the standards and requirements, the SCO's opinion would be that the independent auditor did not comply with auditing standards and state and federal requirements. Such an opinion would result in a referral of the independent auditor to the California State Board of Accountancy.

The SCO issued two final reports during fiscal year 2006-07. Both of the independent auditors complied with the majority of auditing standards and state and federal requirements.

## Appendix A— Audit Report and Interim Report Disclosures of Impending Financial Problems

County School District/County Office	Full Disclosure in Auditor's Opinion	Full Disclosure in Financial Statement and Accompanying Notes	2005-06 Average Daily Attendance	2006-07 Interim Report		2005-06 Interim Report Second
				First	Second	
<b>Alameda County:</b>						
1. Alameda City Unified	No	No	10,563	P	Q	P
2. Oakland Unified	<sup>3</sup>	<sup>3</sup>	<sup>3</sup>	Q	Q	N
<b>Amador County:</b>						
3. Amador County Office	No	No	283	Q	Q	Q
4. Amador County Unified	No	Yes <sup>1</sup>	4,366	Q	Q	Q
<b>Butte County:</b>						
5. Biggs Unified	Yes	Yes	678	N	N	N
<b>El Dorado County:</b>						
6. Gold Oak Union Elementary	No	Yes <sup>1</sup>	676	Q	Q	Q
<b>Fresno County:</b>						
7. Golden Plains Unified	No	No	1,785	Q <sup>2</sup>	Q	P
8. Parlier Unified	Yes	Yes <sup>1</sup>	3,285	N <sup>2</sup>	N	N
9. West Fresno Elementary	<sup>3</sup>	<sup>3</sup>	<sup>3</sup>	Q	Q	Q
<b>Humboldt County:</b>						
10. Eureka Unified	No	No	5,473	Q	Q	P
<b>Kern County:</b>						
11. Pond Union	No	No	219	P	N	P
<b>Lassen County:</b>						
12. Fort Sage Unified	No	Yes <sup>1</sup>	173	Q	Q	Q
13. Johnstonville Elementary	No	No	264	Q	Q	Q
<b>Los Angeles County:</b>						
14. Eastside Union	No	No	2,709	Q	P	P
<b>Mendocino County:</b>						
15. Ukiah Unified	No	No	6,095	Q	Q	P
<b>Nevada County:</b>						
16. Ready Springs	No	No	345	Q	P	P
17. Twin Ridges Elementary	No	No	2,041	Q	Q	P
<b>Placer County:</b>						
18. Western Placer Unified	No	No	4,737	P	Q	P
<b>Plumas County:</b>						
19. Plumas Unified	<sup>3</sup>	<sup>3</sup>	<sup>3</sup>	Q	Q	P
<b>Sacramento County:</b>						
20. Del Paso Heights Elementary	No	No	1,754	Q <sup>2</sup>	Q <sup>2</sup>	P
<b>San Mateo County:</b>						
21. San Mateo Union High	No	Yes <sup>1</sup>	10,279	Q	Q	P
<b>Shasta County:</b>						
22. Junction Elementary	No	No	25	Q <sup>2</sup>	Q <sup>2</sup>	P
<b>Solano County:</b>						
23. Vallejo City Unified	<sup>3</sup>	<sup>3</sup>	<sup>3</sup>	N	N	N
<b>Sonoma County:</b>						
24. Healdsburg Unified	No	No	2,379	Q	N <sup>2</sup>	Q

## Appendix A (continued)

County School District/County Office	Full Disclosure in Auditor's Opinion	Full Disclosure in Financial Statement and Accompanying Notes	2004-05 Average Daily Attendance	2005-06 Interim Report		2004-05 Interim Report Second
				First	Second	
<b>Stanislaus County:</b>						
25. Knights Ferry Elementary	No	No	139	P	Q	P
<b>Tuolumne County:</b>						
26. Twain Harte-Long Barn Union Elem.	No	No	462	Q <sup>2</sup>	Q	P

Legend: P = Positive Q = Qualified N = Negative

<sup>1</sup> Disclosed in the Schedule of Findings and Questioned Costs.

<sup>2</sup> County office of education changed certification.

<sup>3</sup> Annual audit report has not been submitted; therefore, the information was not available.



## Appendix B— Local Education Agencies Filing Qualified or Negative Interim Reports

County	School District/County Office	1 <sup>st</sup> /2 <sup>nd</sup> Certification	Analysis of Key Indicators for Financial Difficulties									
			Deficit	Declining	Below/	Salary and	Encroach-	Health/	Charter	Forest	District	Other
			Spending	Enrollment	Inadequate	Benefit	ment Issues	Welfare	School	Reserve	Management	
				Reserves	Negotiations		Benefit Issues	Issues	Funds Loss	Issues		
Alameda County:												
	1. Alameda City Unified	P/Q	3	3	3	3						
	2. Oakland Unified	Q/Q	3	3	3						3	
Amador County:												
	3. Amador County Office	Q/Q	3	3	3				3			
	4. Amador County Unified	Q/Q	3	3	3				3			
Butte County:												
	5. Biggs Unified	N/N		3	3			3			3	
El Dorado County:												
	6. Gold Oak Union Elementary	Q/Q		3		3			3			
Fresno County:												
	7. Golden Plains Unified	Q/Q	3	3	3	3						
	8. Parlier Unified	N/N	3	3	3			3		3		
	9. West Fresno Elementary	Q/Q	3	3	3							
Humboldt County:												
	10. Eureka Unified	Q/Q		3		3	3					
Kern County:												
	11. Pond Union	P/N									3	
Lassen County:												
	12. Fort Sage Unified	Q/Q	3		3	3			3			
	13. Johnstonville Elementary	Q/Q	3	3			3			3		
Los Angeles County:												
	14. Eastside Union	Q/P	3		3		3					
Mendocino County:												
	15. Ukiah Unified	Q/Q	3	3	3	3						
Nevada County:												
	16. Ready Springs	Q/P	3	3								
	17. Twin Ridges Elementary	Q/Q	3		3			3				
Placer County:												
	18. Western Placer Unified	P/Q	3			3	3	3				
Plumas County:												
	19. Plumas Unified	Q/Q	3	3	3				3			

## Appendix B (continued)

County	1 <sup>st</sup> /2 <sup>nd</sup> Certification	Analysis of Key Indicators for Financial Difficulties									
		Deficit Spending	Declining Enrollment	Below/ Inadequate Reserves	Salary and Benefit Negotiations	Encroach- ment Issues	Health/ Welfare Benefit Issues	Charter School Issues	Forest Reserve Funds Loss	District Management Issues	Other
Sacramento County:											
20. Del Paso Heights Elementary	Q/Q	3	3			3				3	
San Mateo County:											
21. San Mateo Union High	Q/Q	3		3	3			3			
Siskiyou County:											
22. Junction Elementary	Q/Q	3	3				3				
Solano County:											
23. Vallejo City Unified	N/N	3	3	3							
Sonoma County:											
24. Healdsburg Unified	Q/N		3	3	3		3				
Stanislaus County:											
25. Knights Ferry Elementary	P/Q	3	3		3	3					
Tuolumne County:											
26. Twain Harte-Long Barn Union Elem.	Q/Q	3	3		3		3		3		

Legend: P=Positive Q=Qualified N=Negative

## Appendix C— Summary of Audit Report Compliance Findings

<u>Program</u>	<u>Description of Problem</u>	<u>Number of Findings</u>
<b>STATE</b>		
Adult Education	Attendance accounting deficiencies	8
	Attendance report does not reconcile	2
	Other findings	5
Longer Instructional Day	Instructional time requirements not met (1 charter school)	20
	Lack of documentation/records	1
	Other findings	5
Continuation Education	Attendance accounting deficiency	5
	Other findings	1
Independent Study	Attendance overstated (2 charter schools)	21
	Contract did not include all required elements (1 charter school)	19
	Work samples not retained	2
	Other findings (1 charter school)	13
Summer School	Attendance accounting deficiencies	3
State Instructional Materials Fund	Expenditures not allowable	17
	Adopted/nonadopted requirements not met (1 charter school)	16
	Interest earned on allowance not allocated to the program	1
	Board resolution did not address sufficiency of textbooks/instructional materials	27
	Public hearing on instructional materials not held or held after June 30	23
	Notice of public hearing deficiency	13
	Other findings	19
Attendance Requirements	More than 30% of allowance and interest expended on nonadopted materials	3
	Excused absences—problems with verification procedures/documentation	4
	Attendance registers/scantrons not signed by teacher	18
	Attendance report does not reconcile to supporting documentation	13
	Attendance report inaccurate/incomplete (2 charter schools)	30
	Lack of documentation/records (1 charter school)	16
	ADA overstated by 0-5 ADA (4 charter schools)	27
	ADA overstated by 5-10 ADA	2
	ADA overstated by 10-20 ADA	7
	ADA overstated by more than 20 ADA	10
	Kindergarten continuation forms not maintained and/or not in compliance with state requirements	56
	Absences claimed for apportionment (3 charter schools)	39
	Teacher(s) did not possess a valid certification document (1 charter school)	11
	Teacher(s) not authorized to instruct limited-English-proficient pupils (1 charter school)	48
	ADA understated by 0-5 ADA (2 charter schools)	25
	ADA understated by 5-10 ADA	4
	ADA understated by 11-20 ADA	1
	ADA understated by over 20 ADA	4
	Enrollment not reconciled to monthly attendance reports	1
	Other findings (1 charter school)	8
	Teachers providing instruction outside of credential document	5

## Appendix C (continued)

<u>Program</u>	<u>Description of Problem</u>	<u>Number of Findings</u>
<b>STATE (continued)</b>		
Gann Limit	Appropriation limit calculation deficiency	1
Calculation	Other finding	1
Class-Size Reduction	Number of classes and pupils reported on Form J-7 CSR understated	37
	Number of classes and pupils reported on Form J-7 CSR overstated	32
	Teacher training not complete/not documented	2
	Lack of documentation/records	1
	Other findings	4
Morgan-Hart Class Size	Number of classes and pupils reported on Form J-9MH-A understated	10
	Number of classes and pupils reported on Form J-9MH-A overstated	8
	Lack of documentation	2
	Other finding	1
Deferred Maintenance	Expenditures not allowable	4
	Matching funds not transferred as of June 30	2
	Other findings	9
Regional Occupational Center/Program	Attendance accounting deficiency	2
	Attendance report does not reconcile to supporting documentation	1
Administrator-to- Teacher Ratio	District has not performed and/or incorrect ratio calculation	3
Community Day Schools	Attendance report inaccurate	5
Child Development	Other finding	1
California School-Age Families Education (Cal-Safe)	Financial report inaccurate/not complete	7
	Cal-Safe ADA overstated	10
	Other findings	4
Proposition 20 Lottery Funds	Expenditures not allowable	27
School Accountability Report Card	School Accountability Report Cards not published	18
	District did not follow uniform compliant process	23
	Other finding	50
Other State Programs	Financial report inaccurate/not complete	5
	Financial report/claim not filed/not filed timely	2
	Other findings (2 charter schools)	<u>13</u>
<b>TOTAL STATE FINDINGS</b>		<u><b>838</b></u>

## Appendix C (continued)

<u>Program</u>	<u>Description of Problem</u>	<u>Number of Findings</u>
<b>FEDERAL</b>		
Special Education	Allowable costs/cost principles	18
	Special tests and provisions	1
Federal Programs	Noncompliance with requirements for allowable costs/cost principles	15
	Noncompliance with requirements for equipment and real property management	1
	Noncompliance with requirements for cash management	2
	Multifunded position not supported by time distribution records	2
	Noncompliance with requirements for procurement/suspension/debarment	3
	Noncompliance with requirements for matching, level of effort, earmarking	1
	Noncompliance with requirements for period of availability of federal funds	2
	Noncompliance with requirements for activities allowed/unallowed	1
	Special test and provisions	2
	Other finding	2
School Breakfast Program	Activities allowed or unallowed	1
Child Nutrition Cluster-NSL	Eligibility	19
	Procurement and suspension and debarment	3
	Special tests and provisions	1
	Activities allowed or unallowed	9
	Other findings	4
Title I-Grants to LEAs	Special tests and provisions	1
	Equipment and real property management	1
	Period of availability of federal funds (1 charter school)	2
	Expenditures overstated	2
	Allowable costs/cost principles	28
	Lack of documentation/records	5
	Activities allowed or unallowed	5
	Eligibility	4
Vocational Education	Other findings	7
	Allowable costs/cost principles	1
Safe and Drug-Free Schools	Activities allowed/unallowed	1
Head Start	Eligibility	2
	Allowable costs/cost principles	2
Other Federal	Reporting	1
	Allowable costs/cost principles	8
	Lack of documentation/records	2
	Special tests and provisions	1
	Subrecipient monitoring	1
	Other findings	9
TOTAL FEDERAL FINDINGS		<u>170</u>
TOTAL STATE AND FEDERAL FINDINGS		<u>1,008</u>

## Appendix D— Summary of Audit Report Deficiencies

Description	Number of Findings	
	2004-05	2005-06
<u>Management's Discussion and Analysis</u>		
The Management's Discussion and Analysis was not included in the audit report.	1	0
<u>Auditor's Opinion</u>		
The auditor's qualified opinion, due to departure from generally accepted accounting principles (GAAP), did not provide substantive reasons for departure and/or did not disclose possible effects on the financial statements.	2	0
The auditor's opinion did not state that the financial statements conformed with accounting principles generally accepted in the USA.	1	0
The auditor's report did not state that the audit was conducted in accordance with auditing standards generally accepted in the USA and government auditing standards (GAGAS).	0	12
Reference to a separate report on internal control over financial reporting and compliance and other matters was not included.	4	4
The auditor's report did not include a manual or printed signature of the auditor's firm and the date of the report.	2	11
The auditor's report did not reference the required supplementary information (RSI).	1	1
The auditor's report did not state that the auditor applied limited procedures to the RSI.	1	1
The auditor's report did not identify supplementary information, including the Schedule of Expenditures of Federal Awards.	0	3
The independent auditor's report did not include an opinion on supplementary information.	0	1
Reference to a separate report on internal control over financial reporting and on compliance and other matters was deficient.	52	94
The auditor's report did not adequately disclose the substantive reasons for the adverse opinion.	3	0
The auditor's report did not identify all component units and/or joint ventures (JPAs) related to the entity.	1	1
Subtotal	67	128
<u>Basic Financial Statements</u>		
Reserves were not appropriate, and their nature and purpose were not clear.	1	19
Governmental entity: The Statement of Changes in Fiduciary Net Assets—Fiduciary Funds was not properly presented.	0	1
Governmental entity: The Statement of Activities was not properly presented.	0	3
Governmental entity: The Statement of Net Assets was not properly presented.	4	3
Governmental entity: The Balance Sheet—Governmental Funds was not properly presented.	1	2
Governmental entity: The Reconciliation of the Government Fund Balance Sheet to the Statement of Net Assets was not properly presented.	3	3
Governmental entity: The Statement of Revenues, Expenses, and Changes in Fund Balances—Governmental Funds was not properly presented.	1	1

## Appendix D (continued)

Description	Number of Findings	
	2004-05	2005-06
<u>Basic Financial Statements</u> (continued)		
Governmental entity: The Reconciliation of the Government Funds Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities was not properly presented.	5	5
Nonprofit entity: The Statement of Financial Position was not properly presented.	0	1
Nonprofit entity: The Statement of Activities was not properly presented.	0	2
Subtotal	<u>15</u>	<u>40</u>
<u>Notes to the Financial Statements</u>		
The notes did not adequately disclose all material items necessary for a fair presentation of the financial statements (long-term debt, issuance of certificates of participation, pension obligations, prior-period adjustments, etc.).	0	5
The notes did not include full disclosure with respect to long-term debt.	24	29
The notes did not adequately disclose prior-period restatements or adjustments.	1	1
The notes did not adequately describe the criteria used in determining whether other entities should be considered component units of the reporting entity.	3	3
The notes did not include adequate disclosure of capital assets and depreciation.	0	6
Subtotal	<u>28</u>	<u>44</u>
<u>Supplemental Information Section</u>		
The Schedule of Expenditures of Federal Awards did not include the required federal catalog numbers, total expenditures for each federal program were not listed, or the schedule did not include all the required programs. For FY 2005-06, the SCO reviewed additional attributes and identified:		
<ul style="list-style-type: none"> <li>• Individual federal programs by federal agency and, for a cluster of programs, individual programs within the cluster.</li> <li>• For federal awards received as a subrecipient, the name of the pass-through entity and the identifying number assigned by the pass-through entity.</li> </ul>	177	114
The notes did not disclose the district's participation in the Early Retirement Incentive program.	16	5
The reconciliation of annual financial and budget report with audited financial statements was not included.	3	4
The Schedule of Instructional Time was not included or the schedule was deficient.	12	56
A note stating that the local education agency received funding for increasing instructional time was not included.	0	66
The Schedule of Average Daily Attendance was not included.	1	37
The Schedule of Financial Trends and Analysis was not included or the schedule was deficient.	0	16
The Schedule of Charter Schools was not included.	3	11
Subtotal	<u>212</u>	<u>309</u>

## Appendix D (continued)

Description	Number of Findings	
	2004-05	2005-06
<u>Internal Control Section</u>		
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards did not reference the financial statements audited.	3	11
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards was deficient.	136	77
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards did not include a statement that the audit was conducted in accordance with GAGAS and auditing standards generally accepted in the USA.	2	0
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards did not include a statement regarding legal restrictions on report distribution.	1	1
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards did not include a statement regarding test results.	9	1
The Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with Government Auditing Standards was not included.	29	115
The management letter was not included in the auditor's report.	30	39
Subtotal	210	244
<u>Federal and State Compliance Section</u>		
The Auditor's Report on State Compliance was deficient.	51	48
The Auditor's Report on State Compliance was not included.	0	55
The Auditor's Report on State Compliance did not include a statement regarding legal restrictions on report distribution.	12	8
The Auditor's Report on State Compliance cited the incorrect reference for the K-12 audit guide.	176	187
The Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133 (Compliance section) was deficient.	1	1
The Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133 (Internal Control over Compliance section) was deficient.	100	160
The Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133 was not included.	1	1
The Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133 did not include a statement regarding legal restrictions on report distribution.	1	0
Subtotal	342	460



## Appendix D (continued)

Description	Number of Findings	
	2004-05	2005-06
<u>Findings and Recommendations Section</u>		
The Schedule of Findings and Questioned Costs was not included.	0	74
No report on the auditee's corrective action plan to eliminate noncompliance was included in the report.	3	3
The audit findings were not coded with the correct five-digit number.	7	11
Noncompliance was reported, but sufficient data was not presented.	5	4
The Schedule of Instructional Time indicated noncompliance with the requirements, but the finding was not included in the report.	8	4
The fiscal impact resulting from noncompliance was not quantified.	31	22
Available reserves were below the minimum required and management's plans were not addressed, and/or a going concern note was not included.	8	3
Sufficient information for judging the frequency and consequences of noncompliance was not included.	7	3
Questioned or unsupported costs material to the financial statements were not properly disclosed.	1	4
The Schedule of Prior Audit Findings was not included.	1	86
Subtotal	71	214
Total number of findings	946	1,439

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